United States Court of Appeals
for the Second Circuit

BRIEF FOR APPELLANT

ORIGINAL 76-6109

IN THE

United States Court of Appeals

For the Second Circuit

VB

e/s

HUNTINGTON TOWERS, LTD.
and RICHARD CAREY,

Plaintiffs-Appellants,

against

FRANKLIN NATIONAL BANK (in liquidation) and
FEDERAL DEPOSIT INSURANCE CORPORATION,

Defendants,

FEDERAL RESERVE BANK OF NEW YORK,
EUROPEAN-AMERICAN BANK, and JAMES SMITH,
individually and as Comptroller of the Currency,

Defendants-Appellees.

On Appeal from an Order of the United States District Court for the Eastern District of New York

BRIEF FOR PLAINTIFFS-APPELLANTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes:

Legislative Material:

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Preliminary Statement

Appellants appeal from an order of the United States District Court for the Eastern District of New York, Judge Orrin G. Judd presiding, granting the motion of the

Federal Reserve Bank of New York (hereinafter "FRB"), European-American Bank (hereinafter "EAB") and James E. Smith, individually and as Comptroller of the Currency (hereinafter "Smith" or "Comptroller") to dismiss the complaint (A159)[1]. A final judgment was entered on July 1, 1976 (A193).

Statement of Issues

1. Whether the District Court made erroneous findings of fact and of law in granting the defendants-appellees' motion to dismiss the complaint.

2. Was it reversible error for the District Court to grant the motions to dismiss the complaint as to defendants-appellees, FRB, EAB and Smith.

Statement of the Case

The Plaintiffs-Appellants

Huntington Towers, Ltd. (hereinafter "Huntington"), is a New York corporation whose sole stockholder is Richard Carey (hereinafter "Carey"). Huntington was the owner and developer of a parcel of improved real estate located along Route 110 in the Town of Huntington, Suffolk County, New York, near the Long Island Expressway. The real estate consisted of three lots. On one lot Huntington had erected an office building referred to herein as Huntington Towers I. On an adjoining lot, Huntington was in the process of constructing another office building referred to herein as Huntington Towers II (A5 and 156).

Plaintiff-Appellant Carey is a developer of real estate in Long Island and elsewhere. He and corporations or-

1. All "A" page references are to the joint appendix filed by appellants herein.

ganized and beneficially held by him (including appellant Huntington) have been customers (depositors and borrowers) of Franklin National Bank (hereinafter "FNB") for many years prior to 1974. FNB has participated in financing Carey and his corporations in their development and construction operations (A5). In November 1973 the appellants entered into an agreement with FNB. FNB agreed to advance such funds as were necessary to complete construction of a proposed second office building (Huntington Towers II) up to a total amount of 5 million dollars against the commitment from a responsible lending institution to issue a permanent mortgage on the completed building in addition to obtaining a major tenant for the completed building. The appellants proceeded with the construction of this building, secured the necessary permanent mortgage commitment and a major tenant for the building. In mid-June 1974 FNB requested and obtained additional security in excess of $3,000,000 from the appellants consisting of certain mortgages on improved and unimproved real property, including the real property described herein, to secure the monies advanced and to be advanced in the future under the construction finance agreement between the appellants and FNB (A6).

Appellants continued to construct the office building through the summer and into the fall of 1974. FNB continued to advance funds from time to time for the construction of this building until October 8, 1974, when FNB was declared insolvent by the Comptroller as hereinafter described. Thereafter, with the exception of one $100,000 advance by EAB, no additional funding was provided to the appellants (A136). At the time the construction of this building stopped in 1974, the steel superstructure was 80% completed. This was one of the major office building construction projects on Long Island at that time and was quite important to the real estate industry (A156).

The European-American Bank (EAB)

The Acquisition of FNB Assets

On October 8, 1974, the Comptroller, acting pursuant to the National Bank Act, 12 U.S.C. §191, certified that FNB was insolvent and appointed the Federal Deposit Insurance Corporation (hereinafter "FDIC") as receiver of FNB as required by the Federal Deposit Insurance Act, 12 U.S.C. §1821(c). Pursuant to the authority given by 12 U.S.C. §192 and 12 U.S.C. §1823(e), the FDIC, as receiver, entered into a Purchase and Assumption Agreement with EAB pursuant to which EAB (1) assumed all of FNB's deposit liabilities and other unsubordinated balance sheet liabilities except FNB's $1.7 billion indebtedness to the FRB, and (2) EAB shall select assets of FNB in an amount equal to the amount of the liabilities assumed less the $125 million purchase premium paid by EAB on October 8, 1974, for the purchase of FNB's banking business (A42-43). Most (but not all) of FNB's assets were held in an asset pool in which the FDIC and EAB had an undivided interest (A52). Some FNB assets were sold to EAB immediately under Section 3.2 of the Agreement. Other FNB assets were retained by the receiver but available for purchase by EAB under Section 4 of the Agreement. During a 180-day period commencing on October 8, 1975, EAB must select those FNB assets that it will acquire. EAB must indicate those FNB assets it does not desire and such assets shall be transferred ultimately to the FDIC in its corporate capacity (A43).

In order to facilitate the Purchase and Assumption Agreement by EAB, the FDIC, in its corporate capacity and not as receiver, has entered into agreements providing that, in such capacity, it will (1) indemnify EAB against unknown losses arising from past actions of FNB (A90); (2) purchase from EAB a 10-year subordinated capital note (A91) in the principal amount of $100 million and (3) as-

sume the $1.7 billion indebtedness owed by FNB to FRB (A44) with an agreement to reduce that indebtedness as FNB's assets, held by the FDIC, are liquidated with a repayment of such indebtedness to be completed in any event (whether or not sufficient assets have been liquidated) by the end of three years (A122). The FDIC will function as a liquidator with respect to FNB's loans which it acquires, and in such capacity, will be interested in obtaining repayment of such loans and not in granting credit. Amounts received in connection with liquidation of FNB's assets will be used to repay the FDIC indebtedness to FRB and to reimburse the FDIC for its liquidation expenses (E1093).[2] Any surplus amounts collected by the FDIC in the course of liquidating FNB's assets will be applied to the satisfaction of claims against the receivership estate and payment in full to subordinate capital debenture holders. All payments by the FDIC other than out of the proceeds of liquidation out of FNB's assets will be paid out of the FDIC permanent insurance fund established under 12 U.S.C. 1821 and paid for by member banks (E1086-87).

The Transaction Between EAB and Appellants

On October 4, 1974, four days prior to the comptroller's declaration of insolvency, George Rilke, then vice president of FNB and the officer in charge of the appellants' account at FNB, authorized the issuance by appellants of a $100,000 check payable to Ikenson Iron Works, Inc., a subcontractor of the appellants on the second office building (A138-39). Ikenson Iron Works, Inc., was the steel subcontractor for the fabrication and erection of the steel framework of the appellants' office building then under construction. The Ikenson check was not presented for collection until on or after October 8, 1974, at which time EAB dishonored the FNB check (A131).

2. All "E" page references are to the Exhibit to the joint appendix filed by appellants herein.

Seymour Ikenson, an officer of Ikenson Iron Works, Inc., called George Hill, chief liquidator of the FDIC, to complain about EAB's refusal to honor a check drawn on appellants' FNB account for $100,000. In addition, Mr. Ikenson had a similar check for $80,000 which had not been deposited for collection. After being advised of the situation, Mr. Hill directed Mr. Ikenson to call Mr. Klaus Jacobs, Vice-President of EAB (now President of EAB). Mr. Ikenson called Mr. Jacobs and explained the situation to him. Shortly thereafter, Mr. Ikenson received a call from EAB requesting that the appellant, Carey, and Mr. Ikenson appear at 9:30 a.m. on Friday, October 18, 1974, at the main office of EAB (A132). At the appointed hour, Ikenson, Carey, Rilke, Vice-President of EAB (formerly Vice-President of FNB) and Jacobs met in Rilke's office at EAB. The dishonored FNB check was returned to Carey by Ikenson. Carey then signed a $100,000 note payable to EAB. Then Mr. Ikenson was presented with an EAB check payable to his company in the amount of $100,000. Ikenson endorsed the check and deposited it to his company's account. At that meeting Mr. Jacobs stated that EAB intended to finance the construction of the Huntington Towers job because EAB has a commitment to Long Island and that nothing will change on the construction of this job. Rilke advised Ikenson that the $80,000 check would be honored the following week (A136). Both Ikenson and Carey understood from their meeting with Mr. Jacobs that EAB had agreed to complete the financing of the construction of Huntington Towers II and that the $100,000 check represented part payment for the continued and further construction of this building (A133). Ikenson continued the steel erection on the construction site (A134).

At that time, the local Long Island newspapers were full of favorable publicity from EAB and FDIC to the effect that EAB would honor all FNB's commitments to Long Island and that no customers or businessmen would

be hurt. Carey had no reason to doubt Mr. Jacob's commitment to continue to finance the construction of this office building. It would be senseless for EAB to fund any further construction in an amount of $100,000 if there was no intention to complete the building (A136).

According to Mr. Rilke's affidavit, the EAB loan of $100,000 is now in default. Presumably EAB now holds the note for the advance of the $100,000 to Ikenson Iron Works, Inc., and will attempt to collect the note from appellants. Mr. Rilke admitted that as officer in charge of appellants' account at FNB, he was familiar with the timetable for construction of appellants' real estate project for which the appellants sought continued financing in October, 1974. However, he denies assurances that financing of this construction job would continue. Further, he denies the existence of any writing in any form in the files of EAB evidencing any agreement by EAB to provide continuing financing to the appellants (A35).

Contrasting this latter statement is the document submitted under the affidavit of James D. Porter, a partner in the appellants' former law firm. This document was obtained under the Freedom of Information Act and although it is on FNB stationery, it acknowledges an understanding to fund the construction of this building by two former officers of FNB who, at the time of the writing of the document, were officers of EAB (A154-55). Mr. Stevenson was then Vice-President in charge of real estate operations for EAB and he specifically consented and agreed to the continued financing of the very project which is the subject of this lawsuit. Both officers were presumably acting in behalf of EAB at the time they signed this document as FNB had ceased to exist. This document was prepared shortly before the additional $100,000 advance on October 18, 1974, to Ikenson by Jacobs of EAB, that was the basis of further and additional reliance by the appellants in continuing the construction of this building (A156).

At all times herein, the appellants relied upon the statements and actions of the officers of FNB and EAB in carrying out their banking responsibilities for their respective banks (A134). The appellants were never advised or informed that FNB was insolvent or that it would not be able to perform its banking functions, including the construction financing of appellants' building to completion (A5). In good faith reliance upon FNB's representations, the appellants were induced into advancing substantial additional security to an insolvent bank, to their great detriment and damage (A6). Appellants would not have given additional security in June of 1974 had they been aware that FNB was then insolvent and would not be able to complete the financing of the construction of the building. When the appellants provided in excess of $3 million additional security in mid-June 1974 to FNB, they substantially and materially impaired their ability to secure financing from other sources to complete the construction of this project (A7). Since the filing of the complaint, the appellant, Carey, has lost, through foreclosure, substantial equity interests in two other office buildings owned by corporations, beneficially owned by him (including Huntington Towers I).[3] The appellants are heavily indebted to contractors and material men for portions of the uncompleted construction. The appellants claim damage amounting to $8 million as the result of the refusal of FNB, EAB and FDIC to continue the financing of this building (A8).

The Comptroller

From July 1973 until 1976, the Comptroller was James E. Smith. FNB was a national bank supervised by the Comptroller. FNB was chartered by the Comptroller's office in 1926. In 1969 the Comptroller approved the corpo-

3. The Roslyn Plaza office building, Roslyn, N.Y., in an action entitled Alison, et al. v. Roslyn Plaza, Ltd., et al., Index No. 2218/75, Nassau Supreme Court, and Huntington Towers I office building in an action entitled in Suffolk Supreme Court.

rate reorganization under which all outstanding shares of FNB, except for director's qualifying shares, were acquired by Franklin New York Corporation (E901). Franklin New York Corporation is publicly owned and its securities are registered with the Securities and Exchange Commission (E907). As of December 31, 1973, FNB was the 20th largest bank in the United States with total resources of $5 billion, total deposits of $3.7 billion and total loans of $2.4 billion. FNB had 104 offices, for the most part, located on Long Island, New York (E901).

Beginning in 1969 FNB began to develop serious problems or extraordinary deficiencies in its operations which continued virtually unabated until it was declared insolvent (E901-06). As of the Comptroller's examination of November 14, 1973, total resources had grown to $4.9 billion or 29% greater than shown by the prior examination of the bank on November 8, 1972. However, the capital of FNB had increased less than one half of one percent and demand and savings deposits had declined by 5.5%. FNB's growth had been financed almost entirely by the use of short term funds, including money market certificates of deposits and time deposits of other banks, totaling $2.3 billion or 50% of FNB's liabilities. These deposits were highly volatile and the Comptroller knew that they would likely be withdrawn from the bank rapidly in the event there was any reason to question the soundness and stability of FNB (A116-17).

The November 14, 1973, bank examination showed uncollectable loans totaling $10 million and loans whose credit quality was criticized, although the loans were not necessarily deemed uncollectable, of $275 million. The amount of the criticized loans equaled 162 percent of the bank's equity capital of $170 million. The bank also had outstanding $3.8 billion in contracts to buy or sell foreign currency at a

future date, a volume which far exceeded the bank's normal needs and showed heavy speculation in foreign currency. Moreover, the bank's operating income was poor. "It was apparent that the bank's poor earnings, potential loan losses, or extended foreign exchange position might easily cause a loss of confidence in the bank, which in turn would result in a serious and overwhelming liquidity crisis" (A117).[4] Such a liquidity crisis occurred on or before the week beginning May 13, 1974, as more fully described hereinafter.

The Federal Reserve Bank of New York

The Franklin National Bank Insolvency

During the week of May 6, 1974, the officers of FNB, the Comptroller, the FDIC, and FRB learned that FNB had suffered severe losses whose exact amount had not been determined. These losses occurred in FNB's foreign exchange department. FNB's parent corporation decided to announce these losses and it became apparent that such an announcement would dry up the bank's sources of borrowed funds resulting in a severe liquidity crisis. In anticipation of this liquidity crisis, FNB sought approval for an immediate and massive loan from FRB (A117).

Meanwhile, during the weekend of May 10, 1974 the Comptroller spoke to John McGillicuddy, president of Manufacturers Hanover Trust Company, concerning an immediate merger of it with FNB. At that time the Comptroller advised McGillicuddy that pursuant to his powers under 12 U.S.C. §181 to waive shareholder approval and under the Comptroller's powers to establish a conservator, the Comptroller might consider an immediate merger transaction (E870).

4. The Court will find a detailed description of FNB's financial condition in the statement of the Comptroller (E908-92[illegible]).

The FDIC was informed on Thursday evening, May 9, 1974, by the Comptroller's office that public announcements to be made the next day (May 10, 1974) by FNB's parent corporation might well precipitate a crisis of confidence in the bank. The announcement to be made on May 10, 1974, included the statement that (a) there would be a passing of regular quarterly dividends, and (b) the bank had a sizable foreign exchange loss of an undetermined amount. The Comptroller expressed a fear that there might be a run on the deposits of the bank (A118).

On Sunday, May 12, 1974, FNB's parent corporation announced: (1) a substantial foreign exchange loss due to unauthorized trading, (2) a plan to raise $50 million in new capital through a right's offering and (3) the likelihood of significant management changes on Monday (A118). In a special news release, issued simultaneously, the Vice Chairman of the Federal Reserve Board of Governors announced that the Federal Reserve System, having been assured of the solvency of FNB by the Comptroller (A14), stood ready to advance FNB the liquidity funds it needed within the limits of the collateral that can be supplied (A15). On Monday, May 13, 1974, at the request of the bank's management, the SEC suspended trading of Franklin's securities, 39 F.R. 18166 (1974). On Monday, May 13, 1974, FNB's parent corporation announced the firing of FNB's president and chief administrative officer and the resignation of its chief international executive. By Wednesday, May 15, 1974, FNB's loan at the FRB discount window had reached $780 million. Within 10 days of May 12, 1974, FRB was required to advance $1.125 billion to enable FNB to meet its present obligations (A117-118). By the end of May, FNB's advance to FRB had climbed to $1.2 billion (E1040-45). Thereafter, the FRB continuously advanced money to FNB to give it the appearance of solvency to meet its present obligations until the Comptroller finally acted on October 8, 1974. By the time FNB was declared insolvent, the FRB

had advanced $1.7 billion into FNB in exchange for collateral to secure the loan in an amount close to $2.3 billion.[5]

The FDIC was kept informed on a current basis of all developments within FNB and had a group of FDIC examiners, along with a task force of the Comptroller's examiners, monitoring daily changes in the bank's condition. The FRB bank examiners reviewed the collateral being provided by FNB for its steadily increasing loan (E1046). During mid-June at FNB's request, appellants gave FNB approximately $3 million additional security consisting principally of mortgages on appellants' property (A6).

By early June, the task force of Comptroller and FDIC examiners, on a crash basis, put together information for the prospective sale of FNB. The FDIC also developed contingency plans, at the initiation of the Comptroller and the Federal Reserve Board, for an FDIC assisted purchase and assumption transaction.[6] The FDIC assisted transaction would have at least three components, including (1) an FDIC indemnity against FNB liabilities not specifically assumed by the purchasing bank; (2) a throwback provision whereby the purchasing bank could return to FDIC undesirable loans and securities; and (3) an FDIC purchase of a capital note issued by the purchasing bank (E1048-49).

On July 2, the Comptroller informed the FDIC that an FDIC assisted sale of all or part of FNB's assets and the assumption of its deposit liabilities was in order. The Comptroller requested the FDIC (as the Federal Reserve System had several weeks earlier requested) that the FDIC initiate discussions with banks to explore the possibility of consummating such an FDIC assisted transaction (E1054).

5. The FRB claimed the loan value of this collateral to be $1,854.4 million (E746).

6. Such an arrangement is only possible where a bank is insolvent, 12 U.S.C. §191.

By Saturday, October 5, 1974, the FDIC informed the Chairman of the Federal Reserve Board and the Comptroller that an arrangement had been made whereby at least two of four prospective purchasing banks would bid on a proposal prepared by the FDIC for the sale of FNB, and that all of the regulatory agencies were prepared to proceed if FNB were declared insolvent (E1075). The Comptroller then acted to declare FNB insolvent (A122-23).

On October 8, 1974, the Comptroller became satisfied that FNB was insolvent and unable to meet the demands of its depositors and unable to pay its just and legal debts (A15). The Comptroller stated that he is not required to wait until the losses he finds in the bank's assets are actually charged against the bank's book equity capital. It is the Comptroller's duty "to determine when a bank has reached the point when it will not be able to meet the obligations to its depositors in the near future" (A123).

The FDIC Board of Directors (Frank Wille, James Smith and George LeMaistre) convened on October 8, 1974, in the Federal Reserve Bank of New York to accept the bid of EAB to become the purchasing and assuming bank of certain of FNB's deposits and liabilities. Such action was taken by the FDIC under the Bank Merger Act and the National Bank Act. An *ex parte* hearing before Judge Judd was held and all final documents were entered into the record. Thereafter, the Court approved *ex parte* the purchase and assumption transaction and all related transactions.[7]

The FDIC, contrary to its practice in all recent bank failures that resulted in an immediate purchase and assumption transaction, decided that it would not, under any circumstances, pay off the FRB loan to FNB in full on the

7. In re, Franklin National Bank, 381 F. Supp. 1390 (J. Judd 1974).

day FNB is declared insolvent.[8] The FDIC acknowledged that a purchase and assumption transaction could have been consummated in May, 1974 but only at some risk to its trust fund (E1083). The FDIC believed that the trust fund that it administers was substantially protected by the five-month delay by the Comptroller in declaring FNB insolvent. During that period of time, the FDIC was permitted to structure a deal that would minimize impact upon it and the FRB, although the general creditors, bondholders and shareholders would suffer some loss (E1083-89). The FDIC, as receiver of a national bank, recognized its fiduciary duty to the creditors of the bank and its shareholders to realize the highest price for the going concern value of FNB. The FDIC also recognized it has a statutory duty to minimize its own loss (E1049-50).

The FDIC clearly knew that the only basis for the continued existence of FNB was the continuous loan to FNB by FRB, for once the eligible collateral of FNB was exhausted, no further loans could be made by it to FRB (E1058). The FDIC recognized the ultimate risk of loss arising out of its purchase and assumption transaction should be placed on the FDIC fund (E1062-1063).

The FDIC knew when FNB closed that many persons who depended on it to meet their credit needs were left without credit facilities. The FDIC may make advances to former customers of FNB to protect existing receivership assets, 12 C.F.R. 306.1 and 306.2.

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8. An interesting and self-serving analysis of the FDIC's position for the eventual insolvency of FNB during the period May 8, 1974, to July 1, 1974, can be found at E1046-54. This analysis demonstrates the fears held by FDIC if it were required to honor the huge lien claimed by FRB and pay it off at once, thus demonstrating the underlying fallacy of the FRB's financing of an insolvent bank. Conceivably, such financing arrangements could wipe out the entire FDIC trust fund.

ARGUMENT

The European-American Bank

I. The agreement herein is a commercial loan not subject to the Statute of Frauds.

The powers and duties of any National Banking Association include the authorization to make real estate loans secured by liens upon unimproved and improved business properties on which a building is in the process of construction within established guidelines, 12 U.S.C. §371(a)(1). The complaint alleges that the plaintiff and FNB entered into an agreement to finance the construction of additional improvements (a second building) on certain described real property and that FNB agreed to and did advance such construction funds (from time to time) against a commitment from a responsible lending institution to issue a permanent mortgage on the completed building. The appellants thereafter advanced $3,000,000 additional security consisting of mortgages on unimproved and improved real property, including mortgages on property other than the subject property (A6). Appellants state the construction of the building would be completed within a year (A137).

Where the collateral for any loan consists partly of real estate security and partly of other security and such loan is made to finance the construction of a commercial building and has a maturity not to exceed 60 months and where there is a valid and binding agreement entered into by a financially responsible lender to advance the full amount of the bank's loan upon completion of the building, then such a loan shall be classed as an ordinary commercial loan whether or not secured by a mortgage or lien on the property upon which the building is being constructed, 12 U.S.C. §371 (a)(3), 12 C.F.R. §7.2400. If a loan is made to finance the construction of a building having a maturity not to exceed

sixty months where there is a valid and binding agreement entered into by a financially responsible lender to advance the full amount of the bank's loan upon completion of the building, the loan may be classed as a real estate loan or a commercial loan, whether or not secured by a mortgage or other lien on the property upon which the building is being constructed, at the option of the national bank that may have an interest in the loan, 12 U.S.C. §371(c).

If a national bank makes a loan to any borrower and looks to repayment by relying primarily on the borrower's general credit standing and forecast of income, with or without security, and where the bank wishes to take a mortgage deed of trust or other instrument upon real estate as a precaution against contingencies, then such a loan shall not be considered as a real estate loan but shall be classed as a commercial loan, 12 U.S.C. §371(e).

The appellant contends a fair reading of the complaint and appellants' affidavits, demonstrate that the agreement to finance construction herein was treated under applicable federal law and by FNB as a commercial loan, thereby taking the entire transaction out of the New York Statute of Frauds, General Obligations Law §5-703. The defense of EAB should be stricken, or at most, must be determined upon the trial of this matter.

II. The part performance of European-American Bank and appellants voids the Statute of Frauds defense.

EAB raised the defense of Statute of Frauds under §5-703 N.Y. General Obligations Law in that EAB claims no writing exists to show that it agreed to finance the construction of Huntington Towers II and that such writing constitutes a sale of an interest in real property. The appellants bought the property, gave a mortgage, made substantial improvements in the property and relied upon continued construction loan advances and became indebted to FNB

and thereafter EAB. EAB, as successor to FNB, made an additional advance toward the construction of this building and the appellants became indebted to EAB by signing a note that presumably required interest payments at the prevailing rate for a corporation. Such performance is of a sufficient magnitude to clearly void the appellees' Statute of Frauds defense under §5-703(4) even assuming that *Sleeth* v. *Sampson,* 237 N.Y. 69, 142 N.E. 355, applies. Even in the absence of FNB's treatment of this transaction as a commercial loan under applicable federal law as set forth in Point I, the lower court could easily have found it to be a commercial loan because of the treatment given to it by both appellants and FNB. Instead, in the teeth of the law and the facts, the lower court determined the transaction to be one for the sale of an interest in real estate and within sufficient part performance to permit equitable relief. This determination does not make sense and should be reversed.

In the case of *Burns* v. *McCormick,* 233 N.Y. 230, 135 N.E. 273, Judge Cardozo stated:

> "Not every act of part performance will move a court of equity, though legal remedies are inadequate, to enforce an oral agreement affecting rights in land. There must be performance 'unequivocally referable' to the agreement, performance which alone and without the aid of words of promise is untelligible or at least extraordinary unless as an incident of ownership, assured, if not existing. 'An act which admits of explanation without reference to the alleged oral contract or a contract of the same general nature and purpose is not in general, admitted to constitute a part performance,' Woolley v. Stewart, 222 N.Y. 347, 351, 118 N.E. 847, 848. What is done must itself supply the key to what is promised. It is not enough that what is promised may give significance to what is done."

This statement of the unique referability rule has seemingly become a judicial condition added to General Obligations

Law §5-703(4), concerning part performance. The Cardozo standard, if it be a valid one, seemingly contracts the broad equitable powers of the court. This standard is easily cited and often misapplied when considered in the context of the facts in *Burns, supra.*

In the case herein, both the facts and the law support granting equitable avoidance of the Statute of Frauds defense. EAB succeeded to the entire real estate portfolio and other records of FNB on October 8, 1974. The same account and loan officer of appellants was knowledgeably present as well as the Vice President of EAB's Real Estate Operations. The Vice-President of EAB even made a small ceremony when issuing the check and added representations of continued funding of the construction project. This is not a case where second and third level employees were dealing with one another. In the case of the appellant, the president, Richard Carey, was representing it. EAB was represented by sophisticated bankers; after all, they just paid $125 million to buy FNB after carefully studying and reviewing the matter. The amount of money involved was considerable (certainly not an ordinary loan) and had to be approved by a high ranking EAB officer. These were businessmen discussing seriou and significant business matters. The meeting took place in the main office of the bank at Franklin Square. It was clear that the appellants and their subcontractor would rely upon the representations made by Mr. Jacobs for EAB. Mr. Carey was not seeking a personal loan. The steel subcontractor was demanding payment for the installation of steel in a major office building in Long Island. Most assuredly, a prudent banker would not extend $100,000 to anyone without asking the purpose of the money and without asking about the security for repayment of that money. EAB had the right at the time it advanced the money to purchase the assets, including the mortgages of the appellants. Based upon the propaganda in the form of news releases by the FDIC and

EAB, it was not unreasonable to believe that the EAB meant to honor FNB's commitments. Why would the appellants sign a note to increase their indebtedness for the construction of a building that was never to be financed or completed? How did a prudent banker expect to be repaid from a contractor in the middle of a major construction project and heavily obligated to FNB through miscellaneous mortgages totaling over $3 million?

The situation presented in this case is materially different from that in *Burns, supra*, and other cases involving disputes over ownership of property. There is no dispute in this case over the ownership of any property. There is a dispute, however, as to the agreement to finance the construction of a building on a parcel of property already subject to a first mortgage held by FNB and in the possession of EAB as part of the pool of assets from which EAB had to select assets to equal the liabilities assumed under the Purchase and Assumption Agreement with FDIC.

The court's attention is respectfully referred to *Sprague* v. *Cochran*, (1894) 144 N.Y. 104, 38 N.E. 1000 and *Smith* v. *Smith*, (1891) 125 N.Y. 224, 26 N.E. 259. In the *Smith* case, the court held that an agreement to give a lien upon land to secure money to be expended in improving it followed by an actual expenditure of the money, and the improvement contemplated, is so far performed that equity does not regard the Statute of Frauds as a defense to an action to enforce the agreement. In the *Sprague* case, the court held there can be no doubt that where one party advances money to another upon the faith and verbal agreement by the latter to secure payment by a mortgage upon certain lands but which is never executed, equity will impress upon the land intended to be mortgaged a lien in favor of the creditor who advanced the money for the security and satisfaction of his debt. The lien attaches upon the payment of the money and unless there is a waiver of it, expressed

or implied, remains and may be enforced so long as the debt itself may be enforced and an action to compel specific performance will lie. Accordingly, mutuality of remedies requires relief from the Statute of Frauds defense raised by EAB. The appellants have suffered irreparable injury as a result of the fraud worked upon them by EAB.

III. European-American Bank anticipatorily breached its duty to protect the assets of Franklin National Bank by failing to continue funding this construction project prior to rejection of the loan.

At the time that EAB refused to honor appellants' request for an additional $80,000 advance shortly after assuming control of FNB's additional assets in October 1974, it anticipatorily breached its obligation and duty owed to the appellants. Under Section 3.7 of the Purchase and Assumption Agreement, EAB agreed to service all additional assets in accordance with normal and prudent banking practices until such assets are either accepted or rejected by the assuming bank (A62). EAB advanced $100,000 and represented that additional advances would be forthcoming and that an $80,000 check would be honored the following week. EAB failed to honor these obligations and failed to service this additional asset of FNB. The issue is not whether or not EAB could have rejected the loan under the agreement. Rather EAB had a duty to service the loan or immediately reject it as this was a major construction project. EAB could not unilaterally refuse to service the loan and then hold the loan without rejecting it while it watched appellants' construction project come to an agonizing and expensive halt. EAB anticipatorily breached its duty to the appellants under the Purchase and Assumption Agreement. Section 3.6(c) and (d) authorizes advances by the assuming bank without consultation with or prior approval of the receiver.

The use of the word "may" in the Purchase and Assumption Agreement must be read in the context of the times and circumstances of EAB's takeover of FNB. If the word "may" is interpreted in its most permissive sense in EAB's favor, then the FDIC, as receiver, should be accountable for preparing and executing an agreement that offered no protection to the many hundreds, if not thousands, of borrowers of FNB who were in need of protection immediately following the takeover of $3.6 billion in assets of FNB when EAB was only to assume $1.4 billion of such assets. Clearly, EAB owed a duty to the appellants and the FDIC to protect the FNB assets while EAB selected or rejected these assets. EAB breached this duty and should be made to answer for this breach.

The indemnity agreement between EAB and the FDIC is irrelevant to the appellants and certainly not a defense as between EAB and appellants. The lower court dismissed EAB from the action and substantially dismissed FDIC as a defendant. The court cannot in one breath state that appellants' prayer for relief should be directed against another defendant and then give the latter defendant substantial sovereign immunity defenses and remove it from the case. The appellants seek evenhanded treatment in its claim and nothing more.

The Comptroller

I. Introduction

The Comptroller is the chief officer of the Bureau of Comptroller of the Currency. The Comptroller is charged with the execution of all laws passed by Congress relating to the issue and regulation of national currency secured by United States bonds and, under the general supervision of the Board of Governors, Federal Reserve System, of all federal reserve notes. He performs his duties under the general direction of the Secretary of the Treasury. He is

responsible for executing laws relating to the national banking system, 12 U.S.C. §§1 and 2. He generally operates under the National Currency Act signed into law by the President on February 25, 1863, and amended and rewritten in 1864, and now known as the National Bank Act. The Comptroller's paramount responsibility is to insure that each national bank is soundly operated and that the National Banking System fills the public need for commercial banking services. The Comptroller has the authority to issue national bank charters, 12 U.S.C. §26, and 12 U.S.C. §35, approve a new branch, 12 U.S.C. §36, approve a merger in which the resulting bank is to be a national bank, 12 U.S.C. §215, and issue rules and regulations governing the corporate structure of national banks and their lending and investment practices. The Comptroller raises his revenue needs from obligatory assessments and fees levied on national banks, 12 U.S.C. §482. He does not now have to seek appropriations or budgetary authorization from Congress. National bank examinations have been the principal tool of the Comptroller's supervision of national banks. The purpose of a bank examination is to determine the liquidity and solvency, present and future of the bank and the legality of the bank's acts. The Federal Reserve Act requires the Comptroller to examine every national bank twice in each calendar year, 12 U.S.C. §481. The Comptroller has the power to publish the bank examination report of a national bank that does not comply within 120 days of any recommendation or suggestion of the Comptroller, 12 U.S.C. §481. The Comptroller has discretion to waive one examination, but not more frequently than once during any two calendar year period.[9]

9. The Commerce, Consumer and Monetary Affairs Subcommittee of the Committee on Government Operations, 94th Congress, 2d Session, prepared H.R. Report 94-1669 entitled, Adequacy of the Office of the Comptroller of the Currency's Supervision of Franklin National Bank. At p. 12 it was stated that the Comptroller did not observe statutorily required bank examination frequency and ignored formal statutory waiver provisions for FNB.

II. The court has personal jurisdiction over the Comptroller.

On October 8, 1974, the Comptroller submitted his personal affidavit to Judge Judd in the U.S. Eastern District Court and thereafter, attended a meeting of the Board of Directors of the FDIC at the Federal Reserve Bank of New York to approve and consummate the various financial transactions, including the transaction that guaranteed payment of FRB's lien by FDIC. It appears that the Comptroller was in New York at FRB on May 12, 1974, when he discussed the merger of FNB with Sindona, the principal shareholder of FNB's parent company, and later telephoned David Kennedy. As a result of this meeting, a serious proposal for a merger with Manufacturers Hanover Trust Company was cancelled. A subcommittee of the Committee on Government Operations described this merger effort as follows:

> "VI. Efforts to Merge Franklin
>
> When Franklin's senior management realized in early May 1974 that the bank could not survive for long as a viable independent entity, they sought a bank of sufficient size and reputation to acquire Franklin and protect its depositors and customers.
>
> During the week of May 6, 1974, merger talks progressed satisfactory with MHT and several other major banks and with the full endorsement of the Comptroller. On Friday afternoon, May 10, Paul Luftig, Franklin's President, met with John McGillicuddy, President of MHT, and they agreed to have their senior executive officers hold an unusual Saturday morning meeting with a view to the possibility of announcing the merger on the following Monday or Tuesday, May 13 or 14. Franklin agreed to McGillicuddy's major condition that none of Franklin's senior officers would be retained by MHT, and they discussed further the problems of Franklin, including the possibility that extensive foreign exchange losses might soon be uncovered.

On Saturday morning, May 11, the senior officers of the two banks met with their attorneys at MHT's headquarters at 350 Park Avenue and walked up to Franklin's headquarters. Franklin's officers felt that substantial progress had been made on Friday and Saturday in the direction of realizing a merger with MHT the following week. On Saturday morning McGillicuddy learned of the magnitude of Franklin's foreign exchange losses but he said this would only affect the price MHT would offer. He reiterated his commitment to 'place a bid on the table' on Monday, May 13. Franklin's extensive Long Island branch network had great value to MHT which lacked a position in the prosperous Long Island market. Finally, despite the foreign exchange losses of $43 million and a $110 million writedown of the municipal bond portfolio, Franklin would still have a positive book value of over $96 million. Based on these facts, Franklin was not only a viable, but should have been a desirable merger partner for MHT at this time. Erich Heinemann felt that MHT believed it would have no effective competition in acquiring Franklin and consequently sought to hold out for a better deal.

Any successful merger between MHT and Franklin would require the support and approval of the appropriate Federal bank regulatory agencies. The extent of the bank regulatory agencies' roles depended on the kind of merger contemplated by the banks.

If the proposed merger was to be a straight statutory merger under New York State law, where the resulting bank would be a national bank, the Comptroller's role would be to approve or deny the application under the provisions of 12 U.S.C. 215a.

However, if a more complex transaction was contemplated, then the OCC's posture would be more critical. For example, if the acquiring partner planned to purchase the assets and assume the deposit liabilities, leaving Franklin to be liquidated under 12 U.S.C. 181, the

Comptroller might be asked to waive the requirement for two-thirds shareholder approval of the sale and dissolution. Under such circumstances the Comptroller might even be asked under the conservatorship powers of 12 U.S.C. 202 to stand in for the shareholders and bank management to conclude such a sale transaction. Indeed, both possibilities were discussed by Gabriel Hauge of MHT and the Comptroller, but neither actions were pursued.

Another alternative would be a financially assisted merger funded by the Federal Government, similar to the transaction where Crocker National Bank took over U.S. National Bank of San Diego. In order for the FDIC to effect such financial assistance, the Comptroller would have to be satisfied that the bank is insolvent and appoint the FDIC as receiver. Then, the FDIC would have to determine that a financially assisted sale would 'reduce the risk or avert a threatened loss of the Corporation (FDIC)' under 12 U.S.C. 1823(e).

Furthermore, under any of the aforementioned alternatives, the Justice Department's antitrust interests would prohibit MHT from acquiring a strong position in the Long Island market absent the unusual circumstances presented in the Franklin case. Considering the Comptroller and Federal Reserve Bank of New York's consent to and involvement in the pursuit of a merger during the week of May 6, it was not unreasonable to expect such support to be forthcoming.

It was Luftig and Heinemann's belief that McGillicuddy was aware of the favorable loan the FDIC made to Crocker National Bank to induce it to take over the United States National Bank in San Diego, and he hoped that MHT could acquire a similar loan as a 'sweetener' in the proposed Franklin merger. Franklin's officers also believed that as a bargaining position, McGillicuddy had to moderate his enthusiasm for the deal, and the discovery on Saturday, May 10, of the $43 million foreign exchange loss gave him a rationale for indicating to the

regulators that MHT could not consummate the merger without some assistance from the regulators. To the surprise of Luftig and Heinemann, the regulators apparently withdrew active support for a merger. They felt that because the regulators accepted Sindona's $50 million offer and hoped that the bank could be turned around, the deal fell apart. However, the OCC and the FDIC indicated that they were never approached with a request for a financially assisted merger.

The Comptroller's hope for Franklin's self-salvation was ill-founded. During the week of May 13, approximately $670 million of Franklin's Federal funds, certificates of deposit and short-term notes became due and no reasonable man could have expected those funds to be rolled over after the disclosure of Franklin's condition and operations. The $50 million infusion of capital would be woefully inadequate and Franklin could not reasonably expect to raise enough funds in the foreseeable future to pay off any $670 million discount window loan to cover its loss of Federal funds and other purchased money. Franklin's officers had advised the president of the Federal Reserve Bank of New York of this fact over the weekend of May 11, 1974.

The Comptroller has contended that he supported the agreement with Sindona and did not declare Franklin insolvent in May 1974 because he 'hoped' that the deteriorated situation could be reversed. However, with the exception of Joseph Barr who was president of Franklin from June 1974 until October 1974, the subcommittee's investigation failed to disclose that anyone involved in the Franklin situation actually believed that confidence in Franklin could be restored.

Frank Wille, of the FDIC, did not express the belief that confidence could be restored in Franklin. He has stated that 'By the time [Franklin] was known to everybody to be a problem, it was in many respects, already too late to perform a rescue operation in the sense that

you could correct the bank's situation and keep it going as an independent institution without a merger of some kind or an acquisition of some kind.'

In a meeting on May 23, 1974, at which the Comptroller, New York Regional Administrator, Edward Lake, an OCC Examiner and a Deputy Comptroller were present (along with personnel from the Federal Reserve, FDIC and Justice Department), Norman Schreiber, president of Franklin, was pessimistic because additional capital funds would serve little purpose if the bank couldn't regain the confidence of the financial community.

The possibility of a $50 million increase in capital was first raised when Franklin sought Federal Reserve approval in January 1974 of its acquisition of Talcott. When the Federal Reserve rejected this acquisition on May 1, 1974, they indicated that this amount was not adequate to meet Franklin's needs. One must speculate why the Comptroller believed only 2 weeks later that $50 million would be adequate to restore public confidence since it would only cover the newly discovered foreign exchange loss and provide little new capital." H.R. Report 94-1669, p. 37-39 (footnotes omitted)

The court has personal jurisdiction over the Comptroller by reason of his acts within this state, CPLR §302(a)1, 2 and 3(i)(ii).

III. Appellants' claim for declaratory and injunctive relief against the unlawful action of the Comptroller is within the jurisdiction of this Court.

The appellants claim that the Comptroller acted in an unlawful manner (1) in failing to declare an insolvent bank insolvent, (2) in purporting to declare an insolvent bank solvent, (3) in actively keeping an insolvent bank open, (4) in consenting to an unlawful preference among credi-

tors in violation of 12 U.S.C. §194, and (5) in failing to take action to have such claimed preferential liens declared null and void for the purpose of effecting a ratable distribution of assets of FNB. Impliedly within these claims is that the Comptroller acted arbitrarily, capriciously, unreasonably and unlawfully in the application of the law to the matters before him and that his exercise of power constituted an abuse, all to the appellants' damage. One would have thought that the right to sue a government officer for specific relief and that a government officer must abide by the rule of law was firmly established by Marbury v. Madison, 5 U.S. (1 Cr.) 138 (1803) and that a government servant is liable for his wrongful acts even though the master is immune from suit, Osborn v. Bank of United States, 22 U.S. (9 Wh.) 738 (1824). The rationale for permitting such a suit, restraining or even directing official action, is the theory that a government agent is not authorized to engage in wrongful conduct and that such wrongful conduct is not the action of the sovereign and may be enjoined. The district courts are vested with jurisdiction to entertain actions to compel a government officer to perform a duty owed to the appellants herein, 28 U.S.C. §1361.[10]

The court has jurisdiction over the Comptroller under 28 U.S.C. §1331 because the appellant has alleged a violation of the National Bank Act by the Comptroller. The appellants claim that an unlawful preference was created with the consent and approval of the Comptroller in favor of a major creditor of FNB to the detriment of other creditors. The Supreme Court has ruled that a suit may lie against a government officer for specific relief where there is a claim that the officer acted in violation of statutory authority, Larson v. Domestic and Foreign Corp., 337 U.S. 682 (1949).

10. For identical reasons, if the FDIC is a government corporation, then it too is subject to the rule of law and jurisdiction lies with this Court under 28 U.S.C. 1361, at least to the extent of getting injunctive and declaratory relief if not for money damages.

The Comptroller claims that his discretion to declare a bank solvent or insolvent is absolute and not subject to review by this Court as being a discretionary action on his part. The FRB claims that the time of insolvency is a delicate matter and, therefore, not subject to after-the-fact review by the court. If the arguments of the Comptroller and the FRB are upheld, then the Comptroller's powers are virtually limitless. That is to say, where there is red, the Comptroller can declare it to be black, and even though everyone else may see red, the Comptroller's determination is absolute and not subject to review. If Congress intended to create an economic czar, as suggested by the Comptroller and FRB, it would have said so. Such an argument should be rejected by this Court.

There can be no question that a reasonable man would have found FNB to be insolvent on or before the week beginning May 13, 1974. In fact, the Comptroller does not even dispute this (E912).

Assuming that FNB was insolvent, what precisely are the powers of the Comptroller to declare a bank solvent if it is insolvent? It is clear that the Congress wanted to give the Comptroller a broad discretion to declare banks insolvent when he is satisfied that a bank is insolvent. The Congress did not wish to formulate an accounting definition of insolvency that would tie the hands of the Comptroller and prohibit his taking action to declare a bank insolvent when it was weak or near to insolvency but not yet insolvent under a mathematical formula. Appellants do not contest the granting of such broad power to the Comptroller except to the extent that it is claimed that such power is not subject to judicial review or accountability to anyone, including the Congress. The absence of judicial review or accountability of the Comptroller makes the grant of power excessive. However, the issue before this Court is not that the Comptroller wrongfully declared a solvent bank insolvent as is the situation in many of the cases where this

power was challenged. What makes this case somewhat unique is that the appellant herein claims that the deputy comptroller improperly declared an insolvent bank to be solvent for purposes that were beyond the powers of the Comptroller, the FDIC and the FRB to effectuate.

The lower court cited one case for the proposition that the Comptroller has the power to declare an insolvent bank solvent, O'Connor v. Bankers Trust Co., 159 Misc. 920, 289 N.Y.S. 252 (N.Y. Sup. Ct. 1936). In the O'Connor case, certain members of the Clearing House Association for New York banks made representations to the Comptroller that they would take over, manage and indemnify any losses that might occur through their operation of the then insolvent Harriman National Bank and Trust Company. Thereafter, the Harriman Bank never reopened after the National Bank Holiday declared by the President in March, 1933. The Comptroller then brought an action to assess member banks of the Clearing House Association for the losses that were sustained by the Harriman Bank when it failed to reopen. The member banks took various positions as to the Comptroller's claims. Some resisted the assessment, including Bankers Trust Company. One of many defenses raised in this suit was illegality of consideration because the contract sued upon was illegal. It was claimed to be illegal because the Comptroller did not have the power to refrain from closing an insolvent national bank. For the O'Connor court to rule against the Comptroller on this point in the context of that case would have resulted in a fraud by the banks upon the Comptroller. The O'Connor court cited Easton v. Iowa, 188 U.S. 220, as authority for the proposition that the Comptroller need not declare an insolvent bank insolvent. The court further cites Washington National Bank of Tacoma v. Eckels, (C.C.) 57 F. 870, 872; United States National Bank of LaGrande v. Pole, (D.C.) 2 F. Supp. 153; Liberty National Bank of South Carolina at Columbia v. McIntosh, (C.C.A.) 16 F.2d 906.

It is submitted that these cases must be narrowly construed and represent exceptional circumstances not herein present. FNB died on the week beginning May 13, 1974, and but for the regulators attaching their life sustaining machinery to FNB, it would not have survived beyond that week. Even so, the bank's vital signs were irreversibly in decline. This is not a case of permitting an insolvent bank to continue to operate where it is marginally insolvent and can manage on its own for a short period of time. This is a case where a bank is affirmatively and actively supported and propped up by the bank regulators for five months and given the appearance of being alive when, in fact, it was dead. There is no case that can be cited that supports the conduct of the Comptroller in his handling of the FNB insolvency.

IV. The Comptroller's knowing failure to act to declare FNB insolvent in mid-May, 1974, and his subsequent ratification of a preferential transfer in favor of FRB is unlawful.

The Comptroller is authorized to declare a national bank insolvent[11] pursuant to the National Bank Act, 12 U.S.C. §191, as follows:

> "**§191. General grounds for appointment of receiver**
>
> Whenever any national banking association shall be dissolved, and its rights, privileges, and franchises

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11. In the November 1973 examination of FNB by the office of the Comptroller in answer to the questions as to whether or not the examined bank is solvent, the examiner wrote "the bank has not been able to meet the day-to-day requirements placed upon it in the ordinary conduct of its business and simultaneously sustain its overly ambitious growth program without the continued and heavy use of borrowing, particularly in the federal funds market." The Comptroller's handbook of examination procedures states that the examiner is responsible for determining if a bank is solvent in two respects: (a) in having collectable assets sufficient to pay depositors and other creditors and (b) in its ability to meet maturing and usual demands. The examiner so informed the Comptroller in November 1973 that it did not meet the Comptroller's standards for solvency. H.R. Report 94-1669, p. 23.

declared forfeited, as prescribed in section 93 of this title, or whenever any creditor of any national banking association shall have obtained a judgment against it in any court of record, and made application, accompanied by a certificate from the clerk of the court stating that such judgment has been rendered and has remained unpaid for the space of thirty days, or whenever the comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs, in either case, appoint a receiver who shall proceed to close up such association."

Pursuant to 12 U.S.C. §91:

"All transfer of the notes, bonds, bills of exchange or other evidence of debt owing to any national banking association * * * all assignments of mortgages * * * all deposits of money, bullion or other valuable thing for its use or for the use of any of its shareholders or creditors; and all payments of money * * * made after the commission of an active insolvency or in contemplation thereof made, with a view to prevent the application of its assets in the manner prescribed, * * * or with a view to the preference of one creditor to another * * * shall be utterly null and void * * *."

Under §91 insolvency means commercial insolvency, that is, the inability to pay obligations and debts as they become due in the regular and ordinary course of business. Willing v. Eveloff, C.C.A. Pa. 1938, 94 F.2d 344, certiorari denied, 305 U.S. 611; Kulman and Co. v. Woolley, C.C.A. Miss. 1936, 83 F.2d 129; Vann v. Federal Reserve Bank of Richmond, D.C., 47 F.2d 786; Smith v. Witherow, 102 F.2d 638.

A bank is in contemplation of insolvency when the fact becomes reasonably apparent to its officers that the bank

will presently be obliged to suspend ordinary operations. Uhl v. First Nat. Bank and Trust Co. of Kalamazoo, D.C. Mich. 1938, 24 F. Supp. 275, affirmed, 94 F.2d 1013, certiorari denied, 304 U.S. 584. A sale or transfer of assets of a national bank, while insolvent or in contemplation of insolvency, is void unless it appears that the intention was to secure ratable distribution of bank's assets to all its creditors.

Whenever the Comptroller shall appoint a receiver, other than a conservator of any insured national bank, he shall appoint the FDIC receiver. Federal Deposit Insurance Act, 12 U.S.C. §1821(c). The FDIC, as receiver of an insolvent national bank, is authorized to make loans whenever the Board of Directors judge that such action will reduce the risk or avert a threatened loss to the FDIC and will facilitate a merger of an insured bank or will facilitate the sale of the assets of a closed insured bank and assumption of its liabilities by another insured bank, 12 U.S.C. §1823(e).

The Congress authorized the FDIC to make loans to closed banks or banks in danger of closing upon such terms and conditions as it may determine, secured in whole or in part by assets of the bank, and such loans may be in subordination to the rights of depositors and other creditors. Such loans may be made when the Board of Directors make a determination that the continued operation of such bank is essential to provide adequate banking service to the community, 12 U.S.C. §1823(c).

The FDIC, as receiver under the direction of the Comptroller, shall take possession of the books, records and assets of every description of such association, collect all debts, dues and claims belonging to it and upon the order of the court of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may

sell all the real and personal property of such association, on such terms as the court shall direct. National Bank Act 12 U.S.C. §192.

Thereafter, the Comptroller shall, from time to time, make a ratable distribution and dividend of the money collected by the receiver on all proved claims of creditors with the remainder of the proceeds, if any, to be paid to the shareholders of the bank, 12 U.S.C. §194. No dividends have been paid to general creditors and years will pass before any dividend will be paid because of the preferred position of FRB and the agreement by FDIC to pay it in full within three years. This transaction has denied creditors of the benefits established by law in their favor. On the other hand, the FDIC seeks to delay the day when it may have shareholder assessments or payments from the trust fund.

The Comptroller, like the FDIC, has a serious conflict of interest problem in the FNB insolvency. He is one of the three directors of the FDIC Board of Directors. As such, he approves their corporate and receivership activities as a voting member of that Board. Simultaneously, he is charged with oversight, but not supervision, of the FDIC as Comptroller. As Comptroller, he appointed the FDIC as receiver of FNB and he has the power to relieve it as receiver. As Comptroller he is responsible for ratable distributions, if any, of the assets of an insolvent national bank such as FNB. As a member of the FDIC Board, he is concerned about protecting its trust fund. He approved the FRB preferential transfer and all of the related transactions designed to protect FDIC and FRB as a Board member. Of course, membership (and ownership) in the FRB club is required of all of the Comptroller's regulated national banks. This is an admittedly brief overview of some of the cross-relationships and conflicts of interest to which the Comptroller is subject. If he is to be annointed as an economic czar in this democracy with absolute power

and with discretion that is not subject to judicial review, the least this court can do for him is to remove, at this time, the heavy burden of his conflict of interest in serving on the FDIC Board of Directors.

The FRB made millions of dollars of advances to FNB based upon a letter of J. T. Watson, Acting Comptroller of the Currency, dated May 10, 1974, which states in part, "We have not received any information which would materially alter our March 8, 1974, conclusion that the bank is solvent. If there is any significant change in the condition of the bank, this office will promptly advise you." (A14).[12] The day this no change in solvency letter was written was the day after FNB's parent corporation advised the regulators that it would make some damaging public announcements as to the bank's condition. It was the very day that substantial foreign exchange transaction losses were announced. All of this information was known to the Comptroller's office as the Comptroller was engaged in telephone conversations and meetings on FNB's insolvency in Washington and New York that very weekend. Despite the representations, "If there is any significant change in the conditions of the bank, this office will promptly advise you", this is the letter of solvency that FRB relied upon in making sizable advances beginning May 13, 1974. How could anyone in the Comptroller's office write such a letter while FNB's already non-liquid position deteriorated on an hourly basis? In fact, on what basis did J. T. Watson presume to act for the Comptroller on this matter on May 10, 1974? It is clear that the Comptroller was acting on this matter on May 11 and 12, 1974, and that statutorily, the power of the Comptroller resides solely in him except during the absence or disability of the

12. The regular Comptroller's bank examination commenced on November 14, 1973, and closed on March 8, 1974. The descriptive word ratings of FNB in the examination report are as follows: Condition of bank, Extremely Poor; Management, Poor; Earnings, Poor; Capital, Inadequate; Internal Controls, Adequate; Future Prospects, Fair. H.R. Report 94-1669, p. 13.

Comptroller, 12 U.S.C. §4. Why then did this major decision of solvency lie on the shoulders of an Acting Comptroller? Even though FRB has a statutory duty to make its own determination of the solvency of member banks before making advances, it relied upon this interestingly worded letter for its subsequent action, yet it is clear that no subsequent letters of solvency were written and that the letter dated May 10, 1974, could not have been written on May 13, 1974. FRB had no reasonable or lawful basis for acting in reliance upon this sham letter on May 13, 1974.

V. The acts alleged in the complaint against the Comptroller and FRB constitute common law fraud under New York statute and case law.

The complaint alleges that the Comptroller and FRB knew FNB was insolvent in the week of May 13, 1974. The Comptroller and FRB knew of the insolvency and participated in keeping the bank open for normal banking activities. In Werner v. Crippen, 1935, 245 App. Div. 363, 282 N.Y.S. 722, affirmed, 270 N.Y. 535, 200 N.E. 305, the court held directors of banks liable under facts as stated above. Liability did not depend upon actual intent to cheat or defraud the plaintiff, a depositor during the period the bank was insolvent but not yet closed. The bank in this case had suffered a steady withdrawal of its deposits and to meet this demand, the bank pledged nearly every asset it owned with other banks to raise cash; yet it could not meet the demands that were likely to be made upon it in the usual and ordinary course of a banking business. The court held that solvency requires not only that the bank have assets equal to liabilities, but that it should be able to pay its obligations as they came due in the usual and ordinary course of banking business.

In *Cassidy* v. *Uhlman,* 1898, 27 App. Div. 80, 50 N.Y.S. 318, reversed on other grounds, 163 N.Y. 380, 57 N.E. 620, the court stated that if a bank remains open for business,

it constitutes a continual representation of solvency, and that those directors who, knowing that the bank is insolvent, participate in keeping it open, take part in the making of a false and fraudulent representation to the depositors, and in the fraudulent suppression of information which they are in duty bound to make known; and that if injury comes from such unlawful acts, the law affords a remedy. The instant case involved a bank with a scarcity of cash, an investigation, discovery of insolvency, "By gosh, the bank is busted"; further investigation with assistance from counsel, and finally, discussion of raising capital to delay the inevitable public disclosure of insolvency.

Under New York law, permitting a bank to remain open for business constitutes a continual representation of solvency casting liability upon the directors of the bank. In the case of FNB, the Comptroller, FDIC and FRB knew it was insolvent and not only permitted FNB to operate after insolvency (passively) but actively encouraged, supported and created the illusion of solvency to the detriment of the unsuspecting public while sophisticated depositors, such as member banks, removed smart money from FNB with the consent and approval of the regulators. The cases that hold there is no duty of the regulators to disclose insolvency to the public do not stand for the proposition that the regulators can actively participate in creating a false impression upon the public with impunity. The Comptroller and the FRB should be made to answer and account for their unlawful activities.

Under New York statutory law, the insolvency of a bankrupt corporation is deemed fraudulent unless its affairs appear upon investigation to have been administered fairly, legally, and with the same care and diligence that agents receiving a compensation for their services are bound by law, to observe, N.Y. Banking Law §665. Under the circumstances the Comptroller, the FDIC, and the FRB should not be permitted to participate with FNB bank officials in what amounts to common law fraud on the

public without being subject to judicial review and accountability to those who were injured by their conduct. The court should recognize the distinction between the ordinary passive role of the regulators and one where they actively assume effective direction and control of an insolvent bank, such as FNB and operate it for their own purposes. Fraud does not become lawful because of the organizational nature of one of the participants. The Comptroller's conduct in this matter should be subject to review by this court and appropriate declaratory and injunctive relief granted.

The Comptroller, the FDIC and the FRB recognized that the impact of the deputy comptroller's certification of solvency in May, 1974, would be to permit the FNB to arrange for massive cash loans at the FRB discount window through pledges of collateral held by FNB. Thereafter, this cash was used to pay sophisticated investors, such as the shareholder/member banks of the FDIC and the FRB who had noninsured deposits with FNB so that they received a massive preference over other general creditors. To the extent that the FRB was made whole on its alleged lien, then the surplus moneys produced each year by the FRB will continue to flow into the Treasury of the United States. On the other hand, the FRB has released its lien on the FNB assets so that the FDIC can be made whole in its liquidation efforts so that the trust fund administered by the FDIC does not suffer any loss. Any losses paid from the trust fund would have the impact of raising the assessments of the FDIC that are levied against insured member banks to make up the loss. The net effect of the many transactions conducted by the regulators between May and October, 1974, was to protect the member/shareholder banks and other banks and the regulators themselves at the expense of the general creditors, debenture holders and shareholders of FNB. The lower court's reading of the law did not find the appellees conduct actionable. The appellants believe this court will disagree with this conclusion.

The Federal Reserve Bank of New York

I. Introduction

Federal reserve banks are corporate creatures of the Congress and come into existence by filing an organization certificate with the Comptroller. Every national bank shall become a member bank of the Federal Reserve System by subscribing and paying for stock in the federal reserve bank of its district and shall thereupon be an insured bank under the Federal Deposit Insurance Act, 12 U.S.C. §282. The Federal Reserve Bank of New York is privately owned by its member banks. Each federal reserve bank is a separate legal entity created pursuant to the Federal Reserve Act and operating under the general supervision of the Board of Governors of the Federal Reserve System. 26 F.R. 12638, Section 3, effective December 15, 1961. Even state banks may become members of the Federal Reserve System by subscribing to the stock of the federal reserve bank organized within the district of the applying bank, 12 U.S.C. §321. Among the enumerated powers of the federal reserve banks is the power to sue and be sued, complain and defend, in any court of law or equity, 12 U.S.C. §341. All suits of a civil nature at common law or in equity to which any federal reserve bank shall be a party, shall be deemed to arise under the laws of the United States and the district courts of the United States shall have original jurisdiction of all such suits, 12 U.S.C. §632.

II. The role of FDIC.[13]

The FDIC is not a federal agency entitled to sovereign immunity.

The FDIC is a mixed ownership corporation created by Congress, 31 U.S.C. §856. Its shares of stock are owned, in part, by the government and the remainder are owned by the federal reserve banks, including FRB. Every federal reserve bank was required to subscribe to the shares of stock in the FDIC in an amount equal to one half of the surplus of such bank, 12 U.S.C. §264(d).[14] Like FNB and FRB, it acts in some respects as an agent and instrumentality of the government and it is subject to federal regulations.

The FDIC was incorporated on June 16, 1933, and was given the power "to sue and be sued, complain and defend, in any court of law and equity, State or Federal. All suits of a civil nature at common law in equity to which the corporation shall be a party shall be deemed to arise under the laws of the United States, and United States District Courts shall have original jurisdiction thereof, without regard to the amount in controvery * * *" 12 U.S.C. §1819.

The FDIC is subject to the rule of law, Osborn, supra; Bank of the United States v. Planters' Bank, 22 U.S. (9 Wh.) 904 (1824). In the latter case, Chief Justice Marshall at 907 said, "When a government becomes a partner in any trading company, it divests itself, so far as concerns the actions of that company, of its sovereign character, and takes that of a private citizen." Congress has accepted the sueability of the government corporation and has, in most cases, provided in the organizing statute that the corporation shall have the power to sue and be sued. The legisla-

13. Judge Judd dismissed the complaint against FRB on the basis of the Federal Tort Claims Act exceptions and for the same reasons as stated for the FDIC (A182). The appellants therefore discuss the rationale of this reasoning.

14. Section 264 has been withdrawn from the Federal Reserve Act and incorporated in the Federal Deposit Insurance Act.

tive intention for sueability of government corporations was mentioned by Justice Frankfurter in Keifer and Keifer v. RFC, 306 U.S. 381 (1939) to show a, "present climate of opinion which has brought governmental immunity from suit into disfavor."

The sue and be sued clauses are entitled to generous treatment as to their scope. In FHA v. Burr, 309 U.S. 242 (1940) at 245, the Supreme Court wrote that in order to limit a sue and be sued clause "it must be clearly shown that certain types of suit are not consistent with the statutory or constitutional scheme, that an implied restriction of the general authority is necessary to avoid grave interference with the performance of a governmental function." It should be noted that where Congress intends to place limitations on free sueability on corporations, it has done so, 12 U.S.C. §91, §632 and §1723(a). All of the mixed ownership government corporations listed at 31 U.S.C. §856 (except the FDIC by judicial precedent) are excepted from the Tort Claims Act. Reason and logic do not support the proposition that the FDIC is entitled to governmental immunity. The court should note the U.S. Attorney has not appeared for the FDIC in this action. The implications of extending sovereign immunity defenses claimed by the FDIC to the FRB as was done by the lower court should be carefully examined by this court. The rationale of the lower court could be extended to include even national banks such as FNB. Such a result was never intended. The judiciary has created a procedural monster by extending governmental sovereign immunity defenses to this insurance company of depositors of national and state banks.

Under the Budget and Accounting Act, the Congress listed wholly owned government corporations and established budgetary controls upon such corporations. At 31 U.S.C. 852 it is stated that whenever it is deemed by the Director of the Office of Management and Budget to be practicable and in the public interest that any wholly owned government corporation be treated with respect to its appropriations, expenditures, receipts, accounting and other

fiscal matters as if it were a government agency other than a corporation, the director shall include, in connection with the budget program of such corporation in the budget a recommendation to that effect. No such provision is stated for mixed ownership government corporations, such as the FDIC.[15]

III. The FDIC, as receiver, cannot ethically determine the validity of a lien of a secured creditor (FRB) who is its shareholder.

The FDIC is a mixed ownership corporation whose stock is owned by member Federal Reserve Banks, including, in part, the Federal Reserve Bank of New York, 12 U.S.C. §1823(f). The FRB claims that it is a secured creditor of FNB to the extent of $1.7 billion. FRB claims this secured creditor status pursuant to its agreement with FNB (A42) and as ratified by its agreement with FDIC thereafter. The appellants claim to be general creditors[16] and challenge the priority of the secured claim of the FRB alleging that (1) the FRB knowingly advanced moneys to an insolvent bank, FNB, for the purpose of achieving a preferred position for itself and member shareholder banks over other creditors in the liquidation of the assets of FNB, and (2) such a preference violated not only the spirit of the Bankruptcy Act,[17] but also 12 U.S.C. §91. In a dispute among the general creditors of FNB who do not accept the preferred position of FRB, the receiver is in no position

15. The only listed mixed ownership government corporations are: (1) the Central Bank for Cooperatives and the Regional Banks for Cooperatives, (2) Federal Land Banks, (3) Federal intermediate credit banks, (4) Federal Home Loan banks, (5) Federal Deposit Insurance Corporation, (6) The National Railroad Passenger Corporation, (7) The Rural Telephone Bank, (8) The United States Railway Association, and (9) The Consolidated Rail Corporation, 31 U.S.C. §856.

16. By reason of extending $3,000,000 in additional security in mid-June, 1974, in consideration for advances made and to be made to finance construction of appellants' office building.

17. TheB ankruptcy Act isi napplicable to national banks.

to make a fair, impartial and reasonable determination when its shareholder, FRB, is the secured creditor. Furthermore, when one considers that the shareholders of the FRB are, by and large the major national and state banks located in the New York region, who were the very banks that were preferred by means of the cash advances made by FRB to FNB between May 10, 1974, and October 8, 1974, the ultimate conclusion must be that the FDIC has a serious conflict of interest as a receiver in acknowledging the claims of FRB. Worse yet, the FDIC, as a corporation, has gone so far as to guarantee its trust funds to pay the FRB for a release of its lien. The courts cannot permit such a tainted transaction to stand. The FRB has obtained a preference for its member banks and other major bank depositors of FNB that its member banks could not have validly obtained by acting in their own behalf. These highly questionable private arrangements made by the FDIC with the FRB, a privately owned bank, in and of themselves constitute a breach of the receiver's duty to other creditors of FNB. The FDIC and the FRB cannot self-deal to protect their respective shareholders. It is certainty that if the lien of the FRB is denied, then the FRB would share pro rata with other general creditors the assets of FNB, and any loss sustained in the liquidation and distribution of assets of FNB would impact on its member banks.[18] The shareholders of every Federal Reserve Bank are individually responsible, equally and ratably, for all contracts, debts and engagements of such bank arising out of advances made to member banks, 12 U.S.C. §521. The shareholder banks of FRB are the general creditors of FNB who directly benefited by the massive loan by FRB to FNB to pay off FRB member banks and other partially or fully uninsured bank depositors without a ratable distribution. Had FNB been declared insolvent on May 10, 1974, the bulk of the general creditors would be member banks of the FRB. In fact, one major reason that FNB was not declared insolvent was undoubtedly to avoid major

18. It is recognized that the earnings of FRB beyond that necessary to pay its shareholders are paid into the U.S. Treasury.

losses to other banks and thereby prevent member banks from having to write off as losses the amounts that they had deposited with FNB and which were not insured through FDIC.

The self dealing and conflict of interest by the banks and their partially or wholly owned regulators (FDIC and FRB) casts considerable doubt upon the validity of the entire FRB-FDIC-EAB transaction. This lien of FRB should be set aside as a preferential transfer in violation of 12 U.S.C. §91.

IV. The court must determine ratable distributions among creditors.

The FDIC, as receiver, is required to pay over to the Treasury of the United States all moneys collected from the receivership estate of the insolvent national bank subject to the order of the Comptroller, 12 U.S.C. §192. The Comptroller shall make a ratable distribution of the money paid over to him (or for his account) by the receiver on all claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction and the remainder of the proceeds shall be paid to the shareholders of the bank or their legal representatives in proportion to the stock held by them, 12 U.S.C. §194.

It is submitted that the recognition and payment of the lien of the FRB ahead of general creditors of FNB is a violation of 12 U.S.C. §194 in that it is unlikely that there will be sufficient funds to make full payment to the general creditors of FNB. A ratable distribution requires that the creditors be paid proportionately. It is for the court to determine the meaning of a ratable distribution in each particular case, though in making that determination, considerations of underlying equitable principles as well as fairness and justice to all interests govern. American Surety Co. of New York v. Bethlehem Nat. Bank of Bethlehem, D.C. Pa. 1940, 33 F. Supp. 722, reversed on other

grounds, 116 F.2d 75, reversed on other grounds, 314 U.S. 314. The FDIC and FRB have agreed among themselves to deny the court the opportunity to determine the question of ratable distributions among creditors and standing to claimed preferences. An *ex parte* hearing is not due process for those who did not attend and were not invited. The lien of FRB should be set aside as a preferential transfer.

V. FRB knowingly extending credit to an insolvent bank cannot obtain a valid lien on the property of the insolvent bank.

In the case of Roberts v. Hill, 24 F. 571 (Cir. Ct. Vt. 1885), the court, in a split decision, stated that a depositor of an insolvent bank who continued his deposit on condition that he be given security in the form of a note which was the property of the bank created a transaction and transfer that could be set aside as a preferential transfer of an insolvent debtor in favor of a creditor. The court stated that a creditor cannot acquire a lien upon a property of a national bank after it has become insolvent. A bank is in contemplation of insolvency when the fact becomes reasonably apparent to its officers that the concern will be presently unable to meet its obligations and will be obliged to suspend its ordinary operations. An intent to give a preference is performed when a payment is made to a creditor by a debtor who knows his own insolvency and, therefore, knows he cannot pay all his creditors in full. The court stated that the provisions of 12 U.S.C. §194 were analogous to the provisions of the Bankruptcy Act which clearly invalidated preferential transfers by insolvent debtors to creditors. The court found that the conduct of the bank was one outside the ordinary course of the bank business and the circumstances were such to impute to the creditor a reasonable cause to believe that the bank was insolvent.

There can be no question that the FRB had reasonable cause to believe that FNB was insolvent. Certainly the immense size of the borrowings of the FNB in the first

few days after May 13, 1974, to the end of the month would have clearly indicated to a reasonably prudent banker that the bank was insolvent. Further, FNB never made any effort to repay FRB, nor did FRB make any effort to collect advances made to FNB. Instead, FNB constantly increased its loan with the FRB until there was little or no equity capital left in the bank. FRB admits that it was well aware of the financial condition of FNB at all times. FRB's examiners reviewed all of the collateral offered to it by FNB on a daily basis. FRB had access to all of the Comptroller's bank examination reports of FNB and could have examined FNB in its own behalf, 12 U.S.C. §§483 and 485. FRB is in no different position than Hill in the above cited case. The lien of FRB should be set aside as a preferential transfer.[19] Texas & Pacific Railway Co. v. Pottoroff, 291 U.S. 245 (J. Brandeis 1934).

VI. The FRB had no power to make advances to an insolvent bank.

The FRB may claim that it was entitled to lend money to a member bank pursuant to 12 U.S.C. §§347 and 347b, Regulation A, 12 C.F.R. §201, effective April 19, 1973, concerning extension of credit by federal reserve banks (A16). Under General Principles, Section 201.2(c) provides that federal reserve credit is available on a short-term basis to a member bank under such rules that may be prescribed and to such extent as may be appropriate to assist the bank in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly adjustment of the bank's assets and liabilities. An orderly

19. "* * * if the Federal Reserve had reason to believe Franklin was insolvent at the time it advanced $1.7 billion, it may have been a party to granting the unsecured creditor banks an invalid preference vis-a-vis other unsecured creditors of Franklin. Such an action would be contrary to the intention of the Federal Bankruptcy Act (11 U.S.C. 96) as well as in violation of the 12 U.S.C. 91 et seq of the National Bank Act." H.R. Report 96-1669, p. 41.

adjustment of assets and liabilities does not include within its normal and reasonable meaning an insolvency.[20]

In the case of FNB, the repayment of the FRB loan will take the FDIC a minimum of three years, during which time extensive and expensive efforts will be made to liquidate many of the assets of the bank. In fact, the loan by the FRB violated the rules under which it operates in that the FRB knew that there was no way for FNB to repay the short term emergency loan which it sought. Section 201.2(e) of Regulation A provides that federal reserve credit is available to assist member banks in unusual or emergency circumstances, such as may result from national, regional or local difficulties or from exceptional circumstances involving only a particular member bank. Reserve banks may make advances to member banks under Section 201.3(a) for not more than 90 days if secured by obligations or other paper eligible under the Federal Reserve Act or under Section 201.3(b) for not more than four months if secured to the satisfaction of the reserve bank. The FRB, in the case herein, not only extended credit to FNB beyond the time limits set forth in its governing regulation, but had the audacity to suggest that by referring to the advances to FNB as daily loans and rolling over these one billion dollar plus obligations for week after week, month after month, it was somehow not violating the spirit, if not the letter of Regulation A. Absolutely no effort was made by FRB to collect the loans for the obvious reason they were uncollectable short of the liquidation of FNB.

The court should take note that the FRB was advancing huge sums of money on a daily basis for many months prior to the week of May 13, 1974. In effect, the FRB was bankrolling the speculations of FNB in 1973-74 in the foreign exchange markets and thereby permitted the bank to give the appearance of solvency to the public from 1973 until October 1974. The FRB knew as early as November 1973

20. The power to make loans to insolvent banks was considered by the Congress and such power was specifically granted to the FDIC 12 U.S.C. §1823(c).

that there was considerable speculation by FNB in foreign exchange business.[21] It is equally clear that the FRB was fully aware of all of the circumstances concerning the insolvency of FNB from as early as May 13, 1974.[22]

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21. Shortly after the Comptroller began the November 13, 1973, bank examination of FNB, officials of Morgan Guaranty Company, which had conducted forward and spot foreign exchange business with Franklin, took the unusual step of requesting a meeting with the Federal Reserve Bank of New York to discuss problems at FNB.

"Morgan had become alarmed at the "dangerous situation" developing from Franklin's heavy and unwarranted foreign exchange trading. Morgan and several other banks had ceased entering into forward foreign exchange transactions with Franklin. Furthermore, many foreign banks were alarmed at Franklin's foreign exchange positions and were refusing to deal further with the bank. This was a dangerous prospect because many of the banks were also suppliers of Franklin's Eurodollar borrowing and their only other contacts with Franklin were in the foreign exchange area. If they became wary of Franklin's foreign exchange policies, they could be expected to withdraw their Eurodollar credits causing a solvency and liquidity crisis at the bank.

As a result of the meeting with Morgan the Federal Reserve agreed that Franklin's "international activities deserved * * * immediate further attention to determine the facts and that these findings should be discussed with the OCC." Subsequently, Franklin confirmed the rumors in a meeting with the Federal Reserve that most banks had stopped doing forward business with them and it was difficult to get spot action. Although they were not Franklin's primary regulator, the Federal Reserve discussed the bank's undercapitalization and advised that it was essential to rectify these and other problems. Franklin's officials agreed. The Federal Reserve officials had the impression that Franklin recognized the problems and would attempt to resolve them." H.R. Report 94-1669, p. 33. (Footnotes omitted.)

22. "V. Federal Reserve Support of Franklin National Bank

In the subcommittee's judgment there was strong indication that Franklin could not survive as a solvent bank, prior to the date (May 13, 1974) on which the Federal Reserve infused unprecedented sums of money into Franklin in an effort to prevent its failure. Despite Franklin's heavy reliance on Certificates of Deposits and Federal funds, by the fall of 1973, 70 out of the 100 largest commercial banks in the country were not willing to sell Federal funds to Franklin.

Franklin's senior management concluded in April 1974 on the basis of extensive computer analyses that the bank would lose between \$5 million and \$7 million during the second quarter of 1974 exclusive of extraordinary losses or writedowns, such as real estate or

(footnote continued on next page)

There is a significant difference between the FRB knowingly lending money to an insolvent bank and lending money to a bank that has a temporary but pressing liquidity problem. Even assuming that the FRB had the right to lend money to an insolvent bank, there must have come a moment of recognition short of October 5, 1974, when the

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foreign exchange losses. They also concluded that the investing public would refuse to roll over $670 million of maturing short-term Franklin obligations upon learning of these projected losses, and that would force Franklin into insolvency.

This conclusion was buttressed by an independent bank management consultant's letter to Franklin's president dated May 1, 1974, which stated that, "the Bank is in *immediate danger of becoming insolvent*" (italic in original) and warned of the pending "financial collapse of the Bank."

It is not the Federal Reserve's practice or policy to rely on the sale of the loan collateral, with its attenuate uncertainties and delays, to recover the funds it advances. When the Federal Reserve Bank of New York asked how Franklin could repay large loans from the Federal Reserve, necessary to Franklin's survival, the bank's senior management replied "there was no way to repay it." The Federal Reserve pursued the charade to justify making a loan to Franklin and insisted that Franklin's officers "give us your ideas any way on how to pay us back." Franklin's president said that any response would have been little more than a "comic letter." Nevertheless the Federal Reserve Bank of New York loaned an unprecedented $1.7 billion to Franklin.

An OCC examiner familiar with Franklin is alleged to have indicated over the weekend of May 2, 1974, that the bank would no longer be a viable institution after the bank opened on May 13, 1974. This same sentiment was repeated by the Regional Administrator at a meeting with Federal Reserve Bank of New York officials on May 10, 1974. Nevertheless, the Comptroller certified that Franklin was solvent and a viable going concern as of the week of May 14, 1974.

The OCC's examiners stated in their May 14, 1974, "special visitation" report that the "bank condition remains hazardous and bank is only able to meet its day-to-day requirements through the assistance of the Federal Reserve Bank." The Comptroller referred to this statement as a reason for not declaring Franklin insolvent during the week of May 14, 1974. That statement, of course, begs the question of solvency because almost any institution would be solvent with a sufficiently large infusion of low-interest funds. As long as the Federal Reserve is willing to supply such funds and is not de-

(footnote continued on next page)

FRB knew that it was violating Regulation A.[23] Section 201.2(g) specifically states that Federal Reserve credit is not a substitute for capital and ordinarily is not available for extended periods. Section 201.2(h) states that all credit extended pursuant to Regulation A must comply with applicable requirements of law and that the FRB must keep itself informed of the general character and amount of the loans of its member banks with a view to ascertaining whether undue use is being made for any purpose inconsistent with the maintenance of sound credit conditions and give consideration to such information in determining whether to extend credit. FRB could not have lawfully made advances to FNB in compliance with Regulation A.[24] This lien claimed by FRB should be set aside as null and void.

Conclusion

For the foregoing reasons, the final judgment of the District Court entered July 1, 1976, dismissing the complaint against the appellees should be reversed.

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October, 1976

manding repayment, any institution would have ample funds with which to pay its other creditors.

Moreover, past experiences with Federal Reserve assistance suggests that one could not expect the Federal Reserve to provide the magnitude of assistance required to maintain Franklin in such an artificial state of solvency. The Federal Reserve had never before extended close to $2 billion for an indefinite number of months. The Regional Administrator stated that he didn't believe the Federal Reserve would lend Franklin the amount of funds which would be apparently needed by Franklin to continue as a viable institution." H.R. Report 94-1669, pp. 35-36. (Footnotes omitted.)

23. Regulation A, §201.2 was changed in September 1974. However, the bulk of the advances by FRB to FNB took place prior to the effective date of the change.

24. The appellants are not in a position (as not having the opportunity for discovery of FRB) to determine if FRB has violated any other provisions or limitations on its extension of credit to FNB.

Service of 2 copies of the within Brief is hereby admitted this 29th day of Oct. 1976

Signed Thomas M Doyle/CGR

Attorney for Defendant-Appellee Federal Reserve Bank of N.Y.

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Signed Sullivan & Cromwell

Attorney for Defendant-Appellee European American Bank

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2 copies received
Hughes Hubbard & Reed
Attys for F.D.I.C. as Franklin Bank in Liquidation

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Signed

Attorney for Defendants - Federal Deposit Ins. Corp and Franklin National Bank (In Liquidation)

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Signed Paul J Curran

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